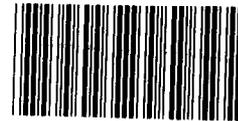


October 1992

AV-8B PROGRAM

Aircraft Sales to Foreign Government to Fund Radar Procurement



147807



United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-247984

October 23, 1992

The Honorable Sam Nunn
Chairman
The Honorable John W. Warner
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Les Aspin
Chairman
The Honorable William L. Dickinson
Ranking Minority Member
Committee on Armed Services
House of Representatives

This report discusses the methods the U.S. Navy used to fund the addition of radar to its AV-8B aircraft. Our review was required by the conference report on the National Defense Authorization Act for fiscal years 1992 and 1993.

This report recommends actions be taken to restore certain foreign military sales proceeds that were improperly spent and ensure such misuse does not recur. It also contains matters for the consideration of Congress to amend the agreements on reprogramming between Congress and the Department of Defense to provide better oversight on program funding.

Please contact me at (202) 275-4128 if you or your staff have any questions concerning this report. Major contributors to this report are listed in the appendix.

Joseph E. Kelley
Director, Security and International
Relations Issues

Executive Summary

Purpose

In 1990 the Navy embarked on a \$401 million program to incorporate radar into the AV-8B aircraft. Senior Navy officials directed that appropriations not be sought for the program, but that it be funded out of available resources. The resulting funding process concerned the Senate and House Committees on Armed Services. Their conference report on the National Defense Authorization Act for fiscal years 1992 and 1993 directed GAO to review the AV-8B radar program. Specifically, GAO was asked to determine whether (1) using proceeds from foreign military sales to fund the radar program was legal and proper and (2) late funding installments on the radar contract led to a violation of the Anti-Deficiency Act.

Background

The AV-8B is a single seat, light attack, vertical/short takeoff and landing aircraft flown by the U.S. Marine Corps. The TAV-8B is its two-seat trainer version. In 1988 the Department of the Navy approved an operational requirement to incorporate radar into the AV-8B. Since the Navy was unwilling to request appropriations for the radar, Navy officials decided to use as sources of funding the proceeds from sales from stock of TAV-8Bs to Italy and freed up appropriations from sales to Italy of AV-8Bs that were under contract.

The AV-8B radar contract contains schedules for the Navy to obligate funds to the program. The Navy, however, was repeatedly late in providing funds to the contractor, and there were concerns that an unfunded liability situation existed—a potential violation of the Anti-Deficiency Act.

Results in Brief

The Navy sold two TAV-8B aircraft to Italy from Defense Department stocks for \$44.4 million and used the proceeds to fund the purchase of radar for its AV-8Bs.¹ The use of foreign military sales proceeds in this manner is not authorized by 10 U.S.C. 114(c) and Department of Defense instructions. In addition, the Navy sold three AV-8Bs to Italy, with Italy assuming the responsibility to purchase these aircraft that the Navy already had under contract. This sale freed up appropriated funds that were used to fund the purchase of the radar. As a result of these sales, the Marine Corps will have five fewer aircraft than Congress had appropriated funds to purchase.

Although the Navy was repeatedly late in providing funds on the AV-8B radar contract, it did not violate the Anti-Deficiency Act. Contract

¹The Navy defines sales from stock to include sales of items under production at the time of the sale.

provisions were written essentially to preclude an unfunded liability situation that could lead to an Anti-Deficiency Act violation.

Principal Findings

Aircraft Sold From Stock Were Not Replaced

Federal statutes require that if the Department of Defense sells defense articles from its inventories to foreign governments, the proceeds of the sale be used to replace the items being sold. If the items are not to be replaced, the proceeds are to be deposited either in the Special Defense Acquisition Fund (a revolving fund used to finance the purchase of military articles for foreign military sales), or if the fund is at its statutory ceiling, in the Treasury as miscellaneous receipts.

The Navy stated that it was using the proceeds of the sale of two TAV-8Bs from stock to procure two AV-8B aircraft for which procurement had previously been authorized and which were already under contract. However, no additional aircraft were purchased as replacements for the two TAV-8Bs that were sold, and accounting documents show that the sale proceeds were actually used to finance the AV-8B radar program. The Navy planned to use the same process to sell a TAV-8B to Spain and use the proceeds for the radar program, but it may now reconsider this action.

In addition to the two TAV-8Bs sold from stock, the Navy sold three AV-8Bs to Italy through a “dependable undertaking” transaction where Italy assumed the contract responsibility for three AV-8Bs the Navy was procuring and had under contract. The TAV-8B and AV-8B sales to Italy resulted in five less aircraft being available for the Marine Corps than Congress had appropriated funds to purchase.

Radar Contract Precludes Unfunded Liability

The AV-8B radar program contract contains schedules for the government’s obligation of program funds. Although the Navy repeatedly missed scheduled funding dates, it did not violate the Anti-Deficiency Act. The contract effectively precludes an unfunded liability from arising because it specifies that the contractor shall not be required to incur liability beyond the amount the government has obligated. If the government does not provide funding by the scheduled dates, and a 30-day grace period has lapsed, the contractor is only to continue work to the extent that there is funding available from the prior installment sufficient to meet the contractor’s termination liability. This contract provision would

prevent an unfunded liability from arising that could result in an Anti-Deficiency Act violation.

Budget Documentation Was Misleading

The Defense Department provided budget documents to Congress supporting a request for fiscal year 1991 appropriations for 24 AV-8Bs. Appropriations were requested for 24 aircraft, even though the Navy had long planned to sell 3 of the aircraft and use the appropriations for those aircraft to buy AV-8B radar. Had Congress been fully informed of the potential sale and the use of the appropriations for radar procurement, it could have made an informed decision on whether it wanted to provide appropriations for this purpose.

Recommendations

GAO recommends that the Secretary of Defense direct that an amount equal to the proceeds from the sale of two TAV-8Bs to Italy, \$44.4 million, be deposited in the Special Defense Acquisition Fund or if the fund is at its statutory ceiling, in the Treasury as miscellaneous receipts. GAO recommends that the proceeds from a potential sale to Spain be similarly handled. GAO further presents matters for congressional consideration in chapter 4 suggesting improvements in the agreement with the Department of Defense on the reprogramming of appropriations from Congress. These suggestions address situations of (1) reductions in procurement quantities due to foreign military sales and (2) use of below threshold reprogramming.

Agency Comments

GAO obtained official oral comments on a draft of this report from the Department of Defense. The Defense Department disagreed with GAO's conclusion that the Navy did not use the proceeds from the sale of two TAV-8B aircraft to procure replacement aircraft and instead used the proceeds to fund the AV-8B radar program. The Department also disagreed with GAO's recommendation to deposit \$44.4 million in the Special Defense Acquisition Fund or the Treasury as miscellaneous receipts. The Defense Department stated that the sale of the aircraft was based on laws and regulations governing replacement-in-kind transactions and that the two TAV-8B aircraft sold from stock were replaced by AV-8B radar-equipped aircraft. However, the Defense Department did not provide evidence that the transaction met the tests and criteria for a replacement-in-kind transaction. GAO's evidence and analysis show the use of the proceeds from this sale was counter to federal statute and Defense Department instructions because (1) the two aircraft sold were not replaced—their

purported replacements were fully funded with appropriations and were under contract before the initiation of the TAV-8B sale and (2) the proceeds of the sale were used to procure AV-8B radar and appropriated funds were used to purchase the purported replacement aircraft. The TAV-8B sale will result in the Marine Corps having two fewer aircraft. Due to the improper use of the sale proceeds, GAO's recommendation to deposit an amount equal to the sale proceeds (\$44.4 million) in the Special Defense Acquisition Fund or the Treasury as miscellaneous receipts is an appropriate corrective action.

The Defense Department also disagreed with GAO's suggestions for congressional consideration to amend the agreements between Congress and the Department of Defense on the reprogramming of appropriations. The Department felt that implementation of the suggestions would unduly limit its flexibility to conduct procurement programs. It indicated that the problems GAO discussed could be addressed by revising its Budget Guidance Manual to provide more explicit guidance to the military departments. Such action would be helpful, but GAO believes that Congress should seek more assurances from the Defense Department.

Contents

<hr/>	
Executive Summary	2
<hr/>	
Chapter 1	8
Introduction	
Radar to Improve AV-8B Capabilities	8
Radar to Be Funded Out of Existing Resources	10
Aircraft Sales As Funding Source	11
Objectives, Scope, and Methodology	12
<hr/>	
Chapter 2	14
Sales of Aircraft From Stock to Fund Radar Program	
Defense Department Sales From Stock Are Not to Fund Procurement	14
Navy Characterized TAV-8B Sale As Replacement-in-Kind Transaction	14
TAV-8B May Be Sold to Spain From Defense Department Stocks	20
Conclusions	20
Recommendations	20
Agency Comments and Our Evaluation	21
<hr/>	
Chapter 3	22
Late Radar Contract Funding and the Anti-Deficiency Act	
Contract Provisions Prevent Anti-Deficiency Violations	22
Funding Repeatedly Late	22
<hr/>	
Chapter 4	24
Budget Documentation and Reprogramming Actions	
Budget Documentation Was Misleading	24
Below Threshold Reprogramming Used to Fund AV-8B Radar	25
Matters for the Consideration of Congress	26
Agency Comments and Our Evaluation	26
<hr/>	
Appendix	28
Appendix I: Major Contributors to This Report	28
<hr/>	
Table	11
Table 1.1: AV-8B Radar Funding Plan	11

Figures

Figure 1.1: AV-8B Harrier	9
Figure 2.1: TAV-8B Sale to Italy From Defense Department Stocks	16
Figure 2.2: AV-8B Sale to Italy Under a Dependable Undertaking	17
Figure 2.3: Effect of Sales on AV-8B Multiyear Procurement	18

Abbreviations

GAO	General Accounting Office
RDT&E	research, development, testing, and evaluation
U.S.C.	United States Code
V/STOL	Vertical/Short Takeoff and Landing

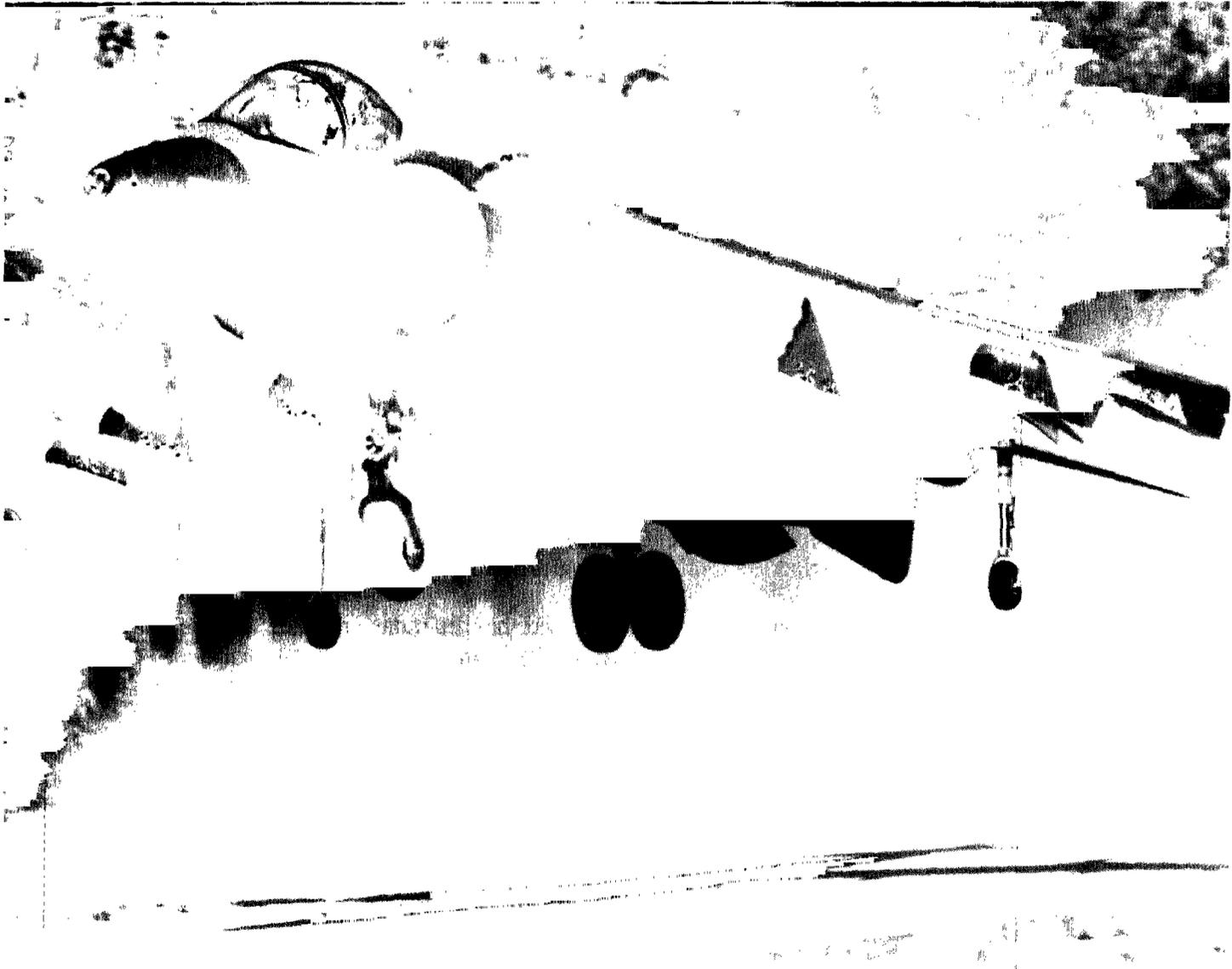
Introduction

In 1988 an examination of expanded roles for the AV-8B revealed the need for a radar system. While approving integration and acquisition of radar for the AV-8B, senior Navy officials were unwilling to seek appropriations for the program due to Navy affordability constraints. They directed that it be funded out of existing resources. The resulting AV-8B radar effort is an estimated \$401 million upgrade program that will provide radar for 21 Marine Corps aircraft. The Navy's funding plan for the radar program included a number of sources, such as contributions from foreign governments for the radar codevelopment effort and sales of aircraft to these partner nations.

Radar to Improve AV-8B Capabilities

The AV-8B (also known as the Harrier II) is a single seat, light attack, Vertical/Short Takeoff and Landing (V/STOL) aircraft flown by the Marine Corps in support of amphibious and land operations (see fig. 1.1). McDonnell Douglas Corporation builds the AV-8B for the U.S. Navy, which is currently procuring these aircraft under a multiyear contract for a mixture of 72 AV-8Bs and TAV-8Bs (the two-seat trainer version of the AV-8B). Twenty-four aircraft a year were funded for fiscal years 1989, 1990, and 1991. These quantities were fixed by a contract modification on September 27, 1989.

Figure 1.1: AV-8B Harrier



Source: U.S. Navy

The currently fielded AV-8Bs do not carry a radar system. Instead, the most recently produced ones rely on an electro-optical Angle Rate Bombing System for daylight weapons delivery and a Forward Looking Infrared system for night attack operations. The Angle Rate Bombing System requires good visibility conditions, and although the infrared system is

designed for nighttime operations, its effectiveness is degraded by clouds, fog, dust, and smoke.

The 1988 examination of expanded roles for the AV-8B led to an approved operational requirement for a multimode radar system. The primary benefit the Navy sought was the capability to deliver air-to-ground weapons in a close air support role in conditions of smoke, dust, haze, marginal weather, or darkness. Collateral benefits of a radar system would be an air-to-air warfare capability and enhanced navigational capabilities.

Radar to Be Funded Out of Existing Resources

The Navy decided to add the APG-65 radar (the radar currently used on the F/A-18) through an engineering change proposal to the 24 AV-8Bs purchased in fiscal year 1991. The radar integration (research and development work) and production costs (both nonrecurring and recurring) were added to the multiyear contract with McDonnell Douglas on November 30, 1990. Since Italy and Spain were interested in procuring radar-equipped AV-8Bs, they signed a memorandum of understanding with the United States to jointly fund and share the benefits of the integration (codevelopment) portion of the radar program. The Navy has estimated that the total radar program will cost \$401 million.

Senior Navy officials stated that the radar program must be a “zero-sum game,” that is, additional appropriations could not be requested for the program. Thus, to remain within Navy affordability constraints, the Navy decided that the program had to be funded from existing resources. This direction resulted in the funding plan shown in table 1.1.

Table 1.1: AV-8B Radar Funding Plan

	Amount (millions)
Integration contract:	
(Codevelopment)	
Funding sources:	
Italian contribution	\$55.0
Spanish contribution	55.0
Nunn Amendment funding ^a	17.0
	\$127.0
Production contract:	
(Nonrecurring and recurring)	
Funding sources:	
McDonnell Douglas ^b	\$18.0
TAV-8B sale to Italy	44.4
AV-8B sale to Italy	71.1
Aircraft Procurement, Navy ^c	56.5
	\$190.0

^aFunds appropriated to finance North Atlantic Treaty Organization cooperative RDT&E (research, development, testing, and evaluation) programs.

^bMcDonnell Douglas agreed to defer compensation for \$18 million of the radar production nonrecurring costs to be recovered from Italy and Spain if the countries decide to join the radar production program.

^cAircraft Procurement, Navy is an appropriation account. These funds already existed in the account for other purposes, and they are to be used for the radar program due to changes in the Navy's requirements.

Source: U.S. Navy

In addition to the radar contract costs shown in the table, the Navy will need to provide \$24 million for testing, \$6.3 million for spares, and \$53.7 million for support equipment. The Navy intended to use appropriations that would be freed up by a TAV-8B sale to Spain to fund some of these expenses. (See ch. 2 for a discussion of this potential sale to Spain.)

Aircraft Sales As Funding Source

Two different types of aircraft sales to Italy were used to help fund the AV-8B radar program. Three AV-8Bs were sold through a "dependable undertaking," and the Navy characterized the sale of two TAV-8Bs and the use of the sale proceeds as a "replacement-in-kind" transaction.

Section 22 of the Arms Export Control Act authorizes the President to enter into contracts for the procurement of defense articles for sale to foreign governments, if the foreign government provides the United States with a dependable undertaking to pay the full cost of the items being

produced and to make funds available to meet payments required by the contract as they become due. In this instance the Navy allowed Italy to buy three radar-equipped AV-8Bs by assuming the Navy's responsibilities under the contract to pay for three AV-8Bs the Navy was acquiring in the fiscal year 1991 portion of the multiyear contract. Italy was required to pay the full cost for those three aircraft in increments as necessary to meet the contract requirements. Our review showed that Italy will pay the full cost of those aircraft. The Navy used the appropriations that had been provided by Congress for those three aircraft to fund the radar effort.

Section 21 of the act authorizes the President to sell defense articles to foreign countries from the stocks of the Department of Defense. If the items sold are to be replaced, the transaction is characterized by Defense Department instructions as either a "replacement-in-kind" or a "replacement" transaction. In a replacement-in-kind transaction, the proceeds of the sale are used to procure an "identical" replacement item. In a replacement transaction the replacement item is an improved model that accomplishes the same basic purpose as the item sold. This transaction the Navy characterized as a replacement-in-kind and will be discussed in chapter 2.

Objectives, Scope, and Methodology

As required by the conference report on the National Defense Authorization Act for fiscal years 1992 and 1993, we reviewed the Navy's AV-8B radar program. Our objectives were to determine if the use of proceeds from foreign military sales to fund the program was legal and proper and if late funding installments on the radar contract violated the Anti-Deficiency Act.

We reviewed the Arms Export Control Act, Department of Defense authorization and appropriation acts, and Defense Department instructions to determine the requirements for use of proceeds from foreign military sales of Department inventories. We reviewed the AV-8B multiyear contract and its modifications, including those incorporating and adding funding for the radar program, to determine if the Navy had violated the Anti-Deficiency Act. We also reviewed other relevant documents, including Letters of Offer and Acceptance for sales of aircraft to foreign governments, Defense Department budget request documentation, AV-8B radar program funding plans, AV-8B pricing data, and Financial Accounting Data Sheets associated with the AV-8B radar program. We interviewed officials from the Office of Management and Budget, the Naval Air Systems Command, the Navy International Programs Office, and the

offices of the Comptroller of the Department of Defense, and the Comptroller of the Navy in Washington, D.C., and McDonnell Douglas Corporation in St. Louis, Missouri.

GAO received written comments on this report from the Department of Defense after the 30 calendar days specified by law; therefore, they have not been reproduced in the report. However, the written views of the agency are similar to those expressed in earlier official oral comments, and they are discussed in chapters 2 and 4.

We conducted our review from January 1992 through May 1992 in accordance with generally accepted government auditing standards.

Sales of Aircraft From Stock to Fund Radar Program

Since senior Navy officials would not request appropriations for the AV-8B radar program, the Navy used other funding sources, including the sale of aircraft from Defense Department inventories. The Navy characterized the sale of two TAV-8B aircraft and its use of the proceeds from that sale as a replacement-in-kind transaction. However, the TAV-8B aircraft sold to Italy were not replaced. The Navy's use of the sale proceeds to help fund the radar procurement was counter to statutory restrictions. In addition, the Navy had planned to sell a TAV-8B to Spain and use the proceeds in the same manner, but may now reconsider this action.

Defense Department Sales From Stock Are Not to Fund Procurement

If, at the time of a sale from stock, the Defense Department intends to replace the articles sold, it then is authorized to use the proceeds of the sale to replace the articles. However, since 1977 a statutory provision contained in the Defense Department's annual appropriation has prohibited the Department from retaining proceeds from sales of defense articles it does not intend to replace at the time of sale. In these instances the sale proceeds are termed "free assets." The legislative history of the statutory prohibition shows Congress intended to close what it considered "a major source of backdoor spending by the Department of Defense".¹ This prohibition was made a permanent part of the United States Code² by section 1481 of the National Defense Authorization Act for 1991, enacted on November 5, 1990. Under this provision, the Defense Department must deposit free assets derived from foreign military sales of its inventories either into the Special Defense Acquisition Fund or if the fund is at its statutory ceiling, into the U.S. Treasury as miscellaneous receipts.³ Free assets cannot be used to procure items that are not replacements for the items sold.

Navy Characterized TAV-8B Sale As Replacement-in-Kind Transaction

On September 12, 1990, the Navy sold two TAV-8B aircraft to Italy from Defense Department stocks. It characterized this sale and its intended use of the sale proceeds as a replacement-in-kind transaction, with the

¹H. Rept. 451, 95th Cong., 1st sess., p. 209 (1977).

²10 U.S.C. 114(c).

³The Special Defense Acquisition Fund is a revolving fund created by chapter 5 of the Arms Export Control Act and is used to finance the procurement of defense articles and services in anticipation of foreign military sales. The fund has a statutory limit of \$1,070,000,000.

replacement aircraft to be two radar-equipped AV-8Bs from the fiscal year 1991 portion of the multiyear AV-8B contract.⁴ The Navy's expressed intent was to procure the two radar-equipped AV-8Bs with the sale proceeds and use the freed-up appropriated funds to finance the radar program.

**Intended Replacement Did
Not Result in Contract for
Additional Aircraft**

The Navy did not enter into new contracts to procure any replacement aircraft, nor were additional quantities of AV-8Bs added to the existing multiyear contract. The AV-8Bs from the fiscal year 1991 portion of the multiyear procurement were fully funded by appropriations and, almost a year before the sale of the two trainers to Italy, were already under contract for production. The Navy did not need the proceeds from the TAV-8B sale to pay for these aircraft. As a result of this sale and the dependable undertaking sale to Italy, the Marine Corps will have five fewer aircraft than originally appropriated and contracted for. (See figs. 2.1, 2.2., and 2.3.)

⁴Defense Department instructions define a replacement-in-kind as the sale of an item from Department stocks and its subsequent replacement with an item of "identical" type, model, and series designation. Despite the fact that a single seat AV-8B cannot perform the two-seat training mission of a TAV-8B, it appears that an AV-8B can meet the nomenclature definition of replacement-in-kind. A TAV-8B and an AV-8B are, by Defense Department definition, the same basic mission designation (A), type (V), design number (8), and series (B). The T designation (for trainer) is a modified mission designation.

Figure 2.1: TAV-8B Sale to Italy From Defense Department Stocks

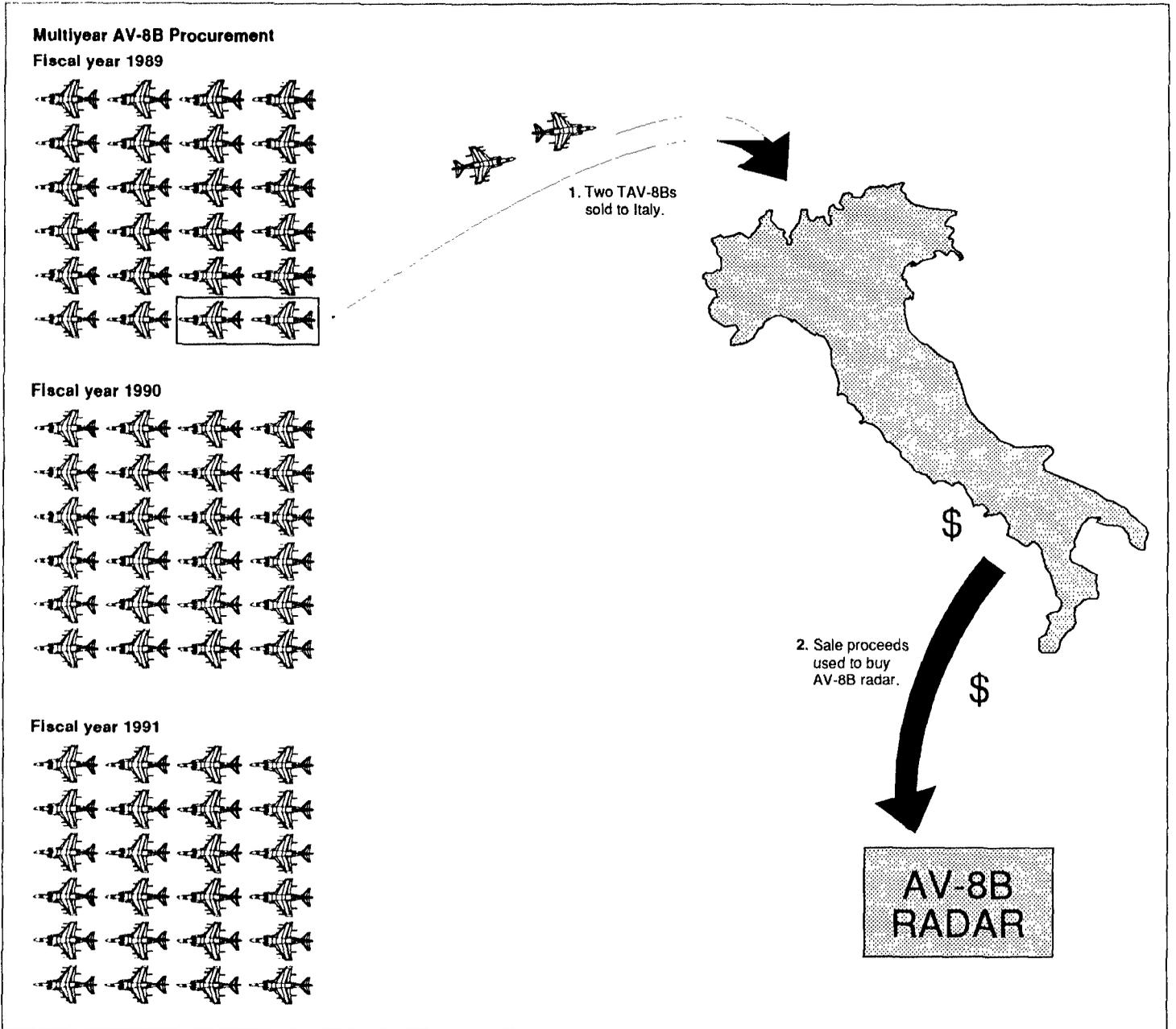


Figure 2.2: AV-8B Sale To Italy Under A Dependable Undertaking

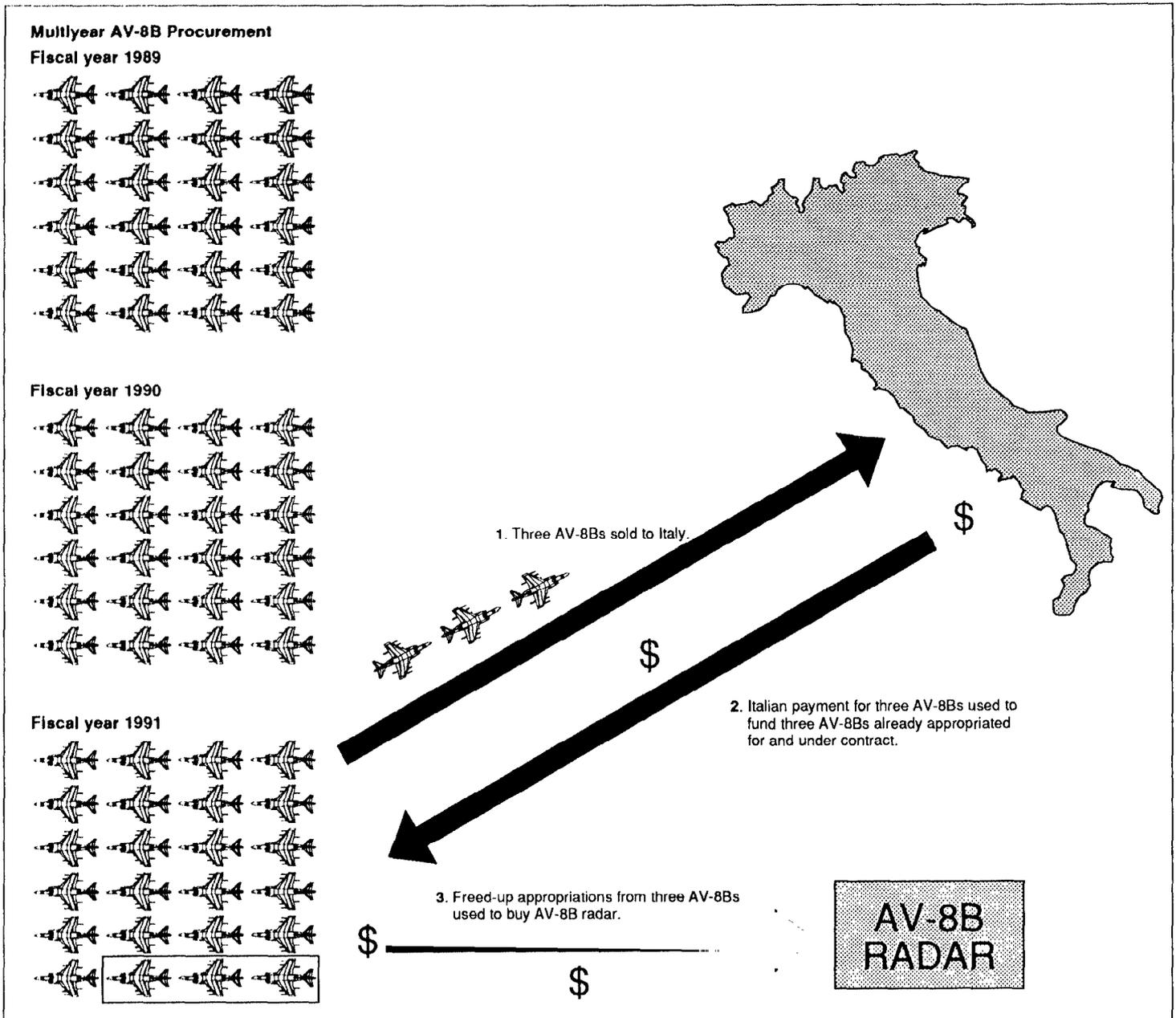
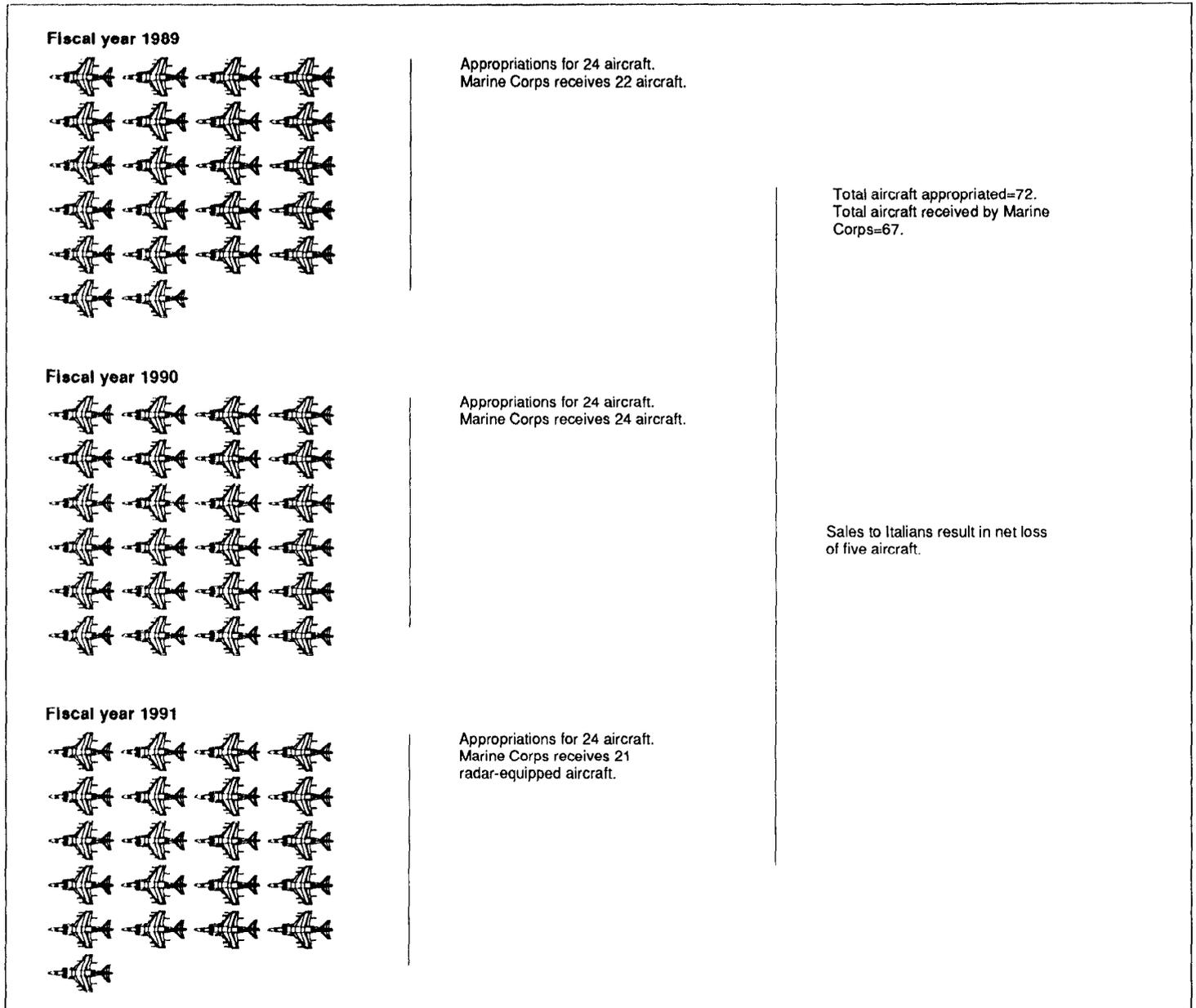


Figure 2.3: Effect Of Sales On AV-8B Multiyear Procurement



Defense Department instructions envision that replacement-in-kind transactions will result in the award of a contract to procure replacement items. In discussing the pricing of items to be sold from Defense

Department stocks, the Department's Foreign Military Sales Financial Management Manual states

"Each sale of a principal or major item requires a test to determine if a requirement for inventory replacement is created as a result of the sale. The test is: Will the sale require award of a contract to replace the item ... at the time the item shall be dropped from inventory?"

If the sale will not result in the award of a contract to replace the item sold, the sale is priced as a free asset transaction.

**Proceeds From TAV-8B Sale
Spent on Radar Procurement**

Navy accounting documents show that the proceeds from the sale to Italy of two TAV-8Bs were applied directly to the AV-8B radar program production costs. The sale proceeds were not used to procure replacement aircraft as the Navy stated—those aircraft were funded with the fiscal year 1991 appropriations. AV-8 program office officials confirmed that the proceeds were spent on the radar program but noted that this was done for "administrative convenience." These officials said that it would have required a large number of administrative accounting actions to use the proceeds of the sale to fund the AV-8Bs, and then transfer the appropriations to the radar program.

**Proceeds From TAV-8B Sale
Could Not Have Bought
Replacement Aircraft**

Even if it had taken the necessary administrative actions, the Navy did not charge Italy a high enough price for the two trainers to procure two replacement radar-equipped AV-8Bs. The Arms Export Control Act requires that if items sold to foreign countries from Defense Department stocks are to be replaced, the price charged be "the estimated cost of replacement of such article." Defense Department instructions further clarify this pricing policy. The Foreign Military Sales Financial Management Manual states that the base cost to be used in the sale price calculation is "the estimated (or actual) cost of the replacement item."

In the case of the TAV-8B sale to Italy, the Navy priced the sale as a replacement of two TAV-8Bs with two TAV-8Bs. However if, as the Defense Department maintains, two radar equipped AV-8Bs were intended to replace the two TAV-8Bs sold to Italy, the sale price should have been based on the cost of two radar-equipped AV-8Bs. Since two radar-equipped AV-8Bs would cost \$5,485,234 more than the amount the Navy charged Italy for the trainers, the proceeds from the sale from stock could not have funded the stated replacements. Nevertheless, the affordability of the AV-8Bs as replacement aircraft did not present a problem for the Navy

since it did not actually use the proceeds from the sale to fund the replacement of the aircraft sold from stock.

TAV-8B May Be Sold to Spain From Defense Department Stocks

The Navy may sell a TAV-8B aircraft to Spain from Defense Department inventories. Congress was notified of this potential sale, but the notification document did not specify that the trainer was to be sold from stock or state how the Navy planned to use the proceeds. Officials from the AV-8 program office stated that the Spanish TAV-8B sale would be handled in the same manner as the Italian TAV-8B sale. They noted that the sale would be a replacement-in-kind transaction and that the proceeds of the sale would be applied to the procurement of one of the radar-equipped AV-8Bs from the fiscal year 1991 procurement. The appropriations for that aircraft would then to be used to fund the AV-8B radar program.

After the congressional notification of this sale and during the course of our review, the Office of the Comptroller of the Department of Defense instructed the Navy that if it sells a TAV-8B to Spain from Defense Department stocks the proceeds would either be used to procure a replacement aircraft (in addition to those for which funds are currently appropriated and which are under contract) or be deposited in either the Special Defense Acquisition Fund or Treasury miscellaneous receipts. The Defense Department has reported that this sale from stock may not occur, but that instead, Spain may procure a TAV-8B under a new contract.

Conclusions

The Navy did not use the proceeds from the sale of two TAV-8B aircraft to Italy to replace the aircraft but rather used the proceeds to fund the AV-8B radar program. The proceeds, therefore, should have been considered free assets. The Navy used those free assets in a manner that is not authorized by 10 U.S.C. 114(c), and that is contrary to Defense Department instructions. Even if the Navy had applied the sale proceeds to two of the AV-8Bs already under contract, the Navy's action would not have been a replacement-in-kind and would have been unauthorized since no additional aircraft would have been procured.

Recommendations

We recommend that the Secretary of Defense take the following actions:

- Direct that an amount equal to the proceeds from the sale of the two TAV-8Bs to Italy, \$44.4 million, be deposited in the Special Defense

Acquisition Fund or if the fund is at its statutory ceiling, in the Treasury as miscellaneous receipts.

- Direct that if the sale from stock of a TAV-8B to Spain occurs, and if the Navy intends to replace the aircraft, an additional TAV-8B or AV-8B be either added to a current contract or included in a new procurement contract. If the Navy does not intend to replace the TAV-8B, the sale proceeds should be deposited in the Special Defense Acquisition Fund or if that account is at the statutory ceiling, in the Treasury as miscellaneous receipts.

Agency Comments and Our Evaluation

The Defense Department disagreed with our conclusion that the proceeds from the TAV-8B sale to Italy were used in an unauthorized manner and should be considered free assets. The Department stated that the sold TAV-8Bs were replaced, while acknowledging that the proceeds from the sale of the two aircraft to Italy did not go directly to purchasing two replacement aircraft, but to funding the U.S. portion of the radar program. The Department stated, however, that the net effect was the same because two aircraft were procured with available Navy appropriated funding. The Defense Department provided no evidence or legal support for its position that the TAV-8Bs were replaced. In actuality the net effect is that the Marine Corps will receive two fewer aircraft because of the TAV-8B sale and the application of the resulting proceeds to the procurement of radar for the AV-8B. The so-called replacement aircraft were already funded with appropriations and were under contract. We believe that the Department should deposit an amount equal to the improperly used proceeds in the Special Defense Acquisition Fund or the Treasury as miscellaneous receipts as an appropriate corrective action.

Late Radar Contract Funding and the Anti-Deficiency Act

The radar contract provides dates by which specific amounts of funds are to be obligated by the government to the radar program. The Navy repeatedly has been late in obligating these scheduled amounts—sometimes by as much as 3-1/2 months. However, the contract provisions essentially preclude an unfunded liability from arising that could violate the Anti-Deficiency Act.

Contract Provisions Prevent Anti-Deficiency Violations

The contract for the AV-8B radar program is funded in installments since funds to cover the total program cost were not available at the program's outset. On scheduled dates the government is to obligate specific amounts of funding.

The contract states:

"In the event the Government fails to obligate any specified installment within 30 days after the time specified, the Contractor will continue performance of the contract only to the extent that he shall not be required to incur obligation ... beyond that amount already obligated by the Government."

Under this clause, the government is only obligated for the amount of funding it has already provided to the program. Consequently, an unfunded liability situation is effectively precluded, and the government's failure to obligate funds by the dates specified would not violate the Anti-Deficiency Act.

If after the 30-day grace period the government does not provide the scheduled funds, and if the funds remaining from the prior installment are not enough to cover the contractor's termination liability, the contract requires the contractor to notify the government. Upon notification, the government contracting officer has 5 days to either provide additional funds or issue a stop work order.

Funding Repeatedly Late

The Navy was often late in obligating funds for the radar program. In a number of instances the obligations were made after the scheduled date but within the 30-day grace period. However, in three cases the grace period had passed, and the contractor, McDonnell Douglas, notified the government that it had used all available funding. McDonnell Douglas retracted or extended its official notifications in two of these cases because it subsequently discovered its subcontractors had sufficient funds

Chapter 3
Late Radar Contract Funding and the
Anti-Deficiency Act

remaining to continue work. In the third case, the Navy obligated funds the same day it was notified. McDonnell Douglas officials stated that the company did not incur expenses beyond the funding necessary to cover its termination liability in any of these cases.

Budget Documentation and Reprogramming Actions

The conference report on the Department of Defense Authorization Act for fiscal years 1992 and 1993 states that the conferees believed that Defense Department communications with Congress on the AV-8B program have been poor. This language was prompted by Navy budget documentation that supported the request for a certain number of AV-8Bs, when the Navy actually intended to acquire fewer aircraft and use the excess appropriations to fund the radar program. Additionally, the Naval Air Systems Command used below threshold reprogramming actions to finance AV-8B radar, although Congress earlier had denied a reprogramming request for the AV-8B program.

Budget Documentation Was Misleading

Documentation provided to Congress was misleading because, long after the Navy determined that AV-8Bs would be sold abroad to fund the radar program, the documentation continued to indicate that the Navy intended to purchase for its own use 24 AV-8B aircraft on the fiscal year 1991 portion of the multiyear contract. Three of these aircraft were subsequently sold to Italy through a "dependable undertaking," and the Navy used the freed-up appropriations to finance the radar program.

An April 1989 funding plan for the AV-8B radar program documented the Navy's intent to use aircraft sales to partially finance the program. This funding plan identified a potential \$60 million from a sale of two TAV-8Bs and associated equipment to Italy. The plan stated "This sale is possible because current procurement on the TAV-8B trainer exceeds our near term requirements." By January 1990 the Marine Corps decided that six aircraft (three TAV-8Bs and three AV-8Bs) would be sold to Italy and Spain to fund the radar program.

Had Congress been fully informed of the potential sale and dependable undertaking before the passage of the fiscal year 1991 Defense Department appropriations act (November 1990), it could have decided whether it wanted to provide appropriations for 24 AV-8Bs in view of the plans to sell 3 of these aircraft to Italy. Budget documentation as late as February 1991 (fiscal year 1992 amended budget request) showed that 24 AV-8Bs were to be procured with the fiscal year 1991 appropriation.

Navy officials told us they are not allowed to show the effect of potential foreign military sales on procurement quantities or prices in budget request documentation. These effects can only be reflected in budget request documentation after a Letter of Offer and Acceptance is signed by a foreign government. However, we believe the Navy could have informed

Congress of its intent to sell three of the fiscal year 1991 AV-8Bs in the narrative portions of its budget request documentation. In comments on a draft of this report, the Defense Department agreed with this conclusion. In our opinion, selling an item through a dependable undertaking for which the Defense Department has requested and received appropriations, and then using these appropriations for something other than they were requested, is tantamount to reprogramming and should be treated as such.

Below Threshold Reprogramming Used to Fund AV-8B Radar

The Defense Department requested approval from Congress to reprogram \$40 million of fiscal year 1991 AV-8B Advance Procurement funds into the AV-8B program to fund radar procurement.¹ On July 22, 1991, the Senate Committee on Appropriations denied this request. The Naval Air Systems Command subsequently executed three reprogramming actions that were below the congressional notification threshold amount and resulted in a net increase of \$25.6 million to the radar program.²

An agreement with Congress, as well as Defense Department instructions, states when Congress should be notified of reprogramming actions. The notification threshold in procurement programs is a cumulative increase to a funding line item in excess of \$10 million. The \$25.6 million increase was considered below the threshold because it was spread among three separate funding lines in the AV-8B program (fiscal year 1990 advance procurement and full funding, and fiscal year 1991 full funding). The increase to each funding line was \$10 million or less. Navy officials contacted a Senate Appropriations Committee staff member before the reprogramming to inform him of their intent to use below threshold reprogramming to fund the radar program. The staff member replied that he could not block below threshold reprogramming but that he disliked the Navy's actions.

The practice of dividing a reprogramming action into multiple reprogrammings to avoid the notification threshold has been used before, and Congress has expressed its disfavor. In its report on the fiscal year

¹The reprogramming action was part of the Defense Department's 1991 Omnibus Reprogramming request.

²According to Navy officials, these funds were a portion of the \$56.5 million of Aircraft Procurement, Navy funds included in the radar funding plan. See table 1.1. The \$40 million appropriation for fiscal year 1991 AV-8B Advanced Procurement was not a source for these reprogramming actions.

1991 Defense Department appropriation bill, the Senate Appropriations Committee noted such activity in Defense Department RDT&E accounts.³ The committee believed that separate below threshold reprogramming actions in amounts that in combination would have exceeded the threshold for a single reprogramming action “violate either the letter or the spirit, or both, of the established reprogramming procedures.”

Matters for the Consideration of Congress

To provide better oversight on program funding, Congress may wish to consider amending its agreements with the Department of Defense on reprogramming to

- add the requirement that any decrease in the procurement quantity of a weapon system for which funds are authorized receive prior congressional approval if the quantity decrease is the result of a foreign military sale and
- ensure that reprogramming thresholds apply to cumulative increases for specific programs during a fiscal year, as well as individual funding lines within the programs.

Agency Comments and Our Evaluation

The Defense Department disagreed with our suggestions to Congress because they would limit the Department’s flexibility to perform its contracting functions and solve its budget execution problems. It stated that amending its agreements with the congressional committees was unnecessary and offered instead to modify its Budget Guidance Manual. We did not determine whether such reprogramming flexibility is necessary or desirable for the Defense Department, because we believe this judgment rests with the authorization and appropriation committees. Our first suggestion is intended to deter future similar use of dependable undertakings that reduce appropriated procurement quantities through foreign military sales without congressional approval. Regarding the use of below threshold reprogramming, the Defense Department commented that although technically correct, the Navy was injudicious in its use of the below threshold authority. Our second suggestion is designed to avoid injudicious use of the below threshold authority in the future.

We believe that modifying the Budget Guidance Manual, if properly implemented, could help prevent such future occurrences, but also believe that amending the agreements could better assure Congress of proper use of these authorities.

³S. Rept. 521, 101st Cong., 2d sess., p. 170 (1990).

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

Thomas J. Schulz, Associate Director
Davi M. D'Agostino, Assistant Director
Peter J. Berry, Evaluator-in-Charge

Office of the General
Counsel, Washington,
D.C.

Alan N. Belkin, Attorney

Ordering Information

The first copy of each GAO report is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

**U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877**

Orders may also be placed by calling (202) 275-6241.

**United States
General Accounting Office
Washington, D.C. 20548**

**Official Business
Penalty for Private Use \$300**

**First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100**
